

Nonprofits Have One More Year to Comply with New Lease Accounting Standards

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In 2016, the Financial Accounting Standards Board (FASB) updated its rules around lease accounting (ASC 842) and closed a diversity in practice in the previous standard. The major change is that organizations must now include lease assets and liabilities on their balance sheets. The upshot is that despite a recently granted extension that applies to private companies and nonprofits, the task of becoming compliant is urgent and challenging. Impacted nonprofits don't have a moment to spare.

Under the previous standards, operating leases were off-balance sheet. That essentially allowed companies to omit certain lease assets and liabilities from their balance sheets, [potentially skewing](#) their debt-to-equity ratio. In 2016, the International Accounting Standards Board estimated that public companies using either the IFRS Standards or U.S. GAAP had around \$3.3 trillion of lease commitments, [85 percent of which](#) were not recorded on their balance sheets. This, of course, makes it difficult for shareholders (stakeholders), investors and lenders to get a true sense of an organization's financial health. Under the previous standard, ASC 840, operating leases were only required to be disclosed in the footnotes of the financial statements. Under ASC 842, the only leases that may be omitted from financial statements are short-term leases with an original term of less than 12 months. ASC 842 increases transparency and comparability among organizations that enter into lease agreements and provided a clearer picture of an organization's liabilities related to leasing obligations. ASC 842 also includes extensive disclosures intended to enable users of financial statements to understand the amount, timing, and judgment related to a reporting entity's accounting for leases and the related cash flows as well as disclosure of both qualitative and quantitative information about leases.

But what it also does is implement a one-size-fits-all accounting standard that significantly increases the

reporting burden on smaller and nonpublic companies, including nonprofits. Implementation will involve significant challenges and require major investments in time, money and other resources. Luckily at its October 16, 2019 meeting, [FASB affirmed its decisions on two proposed Accounting Standards Updates \(ASUs\)](#) — one of which extends the implementation deadline for the new standards on leases that are not yet effective for private companies and nonprofits to the first fiscal year after Dec. 15, 2020, instead of Dec. 15, 2019, as originally mandated.

This is good news for nonprofits, which now have an extra year to implement these changes. At the same time, it should also serve as a wake-up call, as many organizations weren't even aware of the change and the task of becoming compliant. Even within this updated timeline, becoming compliant will be a significant lift.

Nonprofits face multiple significant implementation challenges such as:

- Identifying embedded leases in business arrangements
- The number of business arrangements that were previously not identified as leases may now be identified as meeting the definition of a lease or embedded lease
- Existing systems and processes may need to be modified or enhanced in order to provide information necessary to address the new reporting and disclosure requirements
- Multiple departments across the organization will be affected by this standard, including information technology, tax, legal, treasury, and financial planning and analysis, among others
- Ongoing efforts to remain compliant might be more significant than the initial implementation effort

It's clear that complying with ASC 842 is a time-consuming process. Organizations should develop an implementation timeline keeping several factors top of mind, including existing lease commitments, data governance maturity and cross-function coordination needs.

To get started, organizations should first learn one of the key lessons from public companies that have already gone through this process: The standard requires the collection of significant data from every lease that exists on, or will exist after, the effective date. Analyzing leases to identify and extract those details for inclusion in the organization's financial reports requires substantial time and resources.

Nonprofits should also consider adopting the following best practices.

Solicit the involvement of the entire organizations:

Although the implementation of ASC 842 is primarily the responsibility of the organization's accounting department, successful implementation requires support from across the firm, especially when an organization has a large real estate portfolio or embedded leases. This may mean seeking assistance from IT, legal, or procurement departments. Soliciting executive sponsorship to champion implementation will also help to streamline the process.

Use technology to your advantage: Under the stress of deadlines, the compilation of lease terms and data can be daunting, especially within larger nonprofits where leases may exist across departments. For organizations that have developed a robust data governance program, or specific procedures to collect and manage enterprise data, implementation should be considerably easier. However, for the many organizations that have yet to build out these structures, there are off-the-shelf and purpose-built technology solutions that can help standardize and aggregate the information.

Keep an open line of communication: Organizations that maintain a large physical footprint are impacted the most. They should factor in extra time for both implementation and keeping stakeholders informed. Unexpected roadblocks such as a delay in receiving necessary data from external sources should also be accounted for in the timeline. Benchmarking the organization's progress on implementation against its timeline throughout the balance of the year is paramount in keeping on task and meeting goals.

The bottom line is that even with the extension it will take a concerted effort to become compliant in time. Nonprofits need to start planning now.

Please [contact CapinCrouse](#) with questions or for assistance with implementing the new standards.

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